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SENSITIVE  
SIPDIS

State for EAP/CM - WKlein, SFlatt  
State for EEB/CIP - SFlynn, FSaeed  
USTR for Awinter, JMcHale, TWineland, JGrier  
Commerce for ITA - IKasoff, NMelcher, ATing  
DOJ for CCIPS - MDubose and SChemtob  
FBI for LBryant  
State for White House OSTP Ambassador Richard Russell  
NSC for Melissa Hathaway

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TAGS: [ETRD](#) [PGOV](#) [PHUM](#) [SOCI](#) [SCUL](#) [ECON](#) [CH](#)  
SUBJECT: CHINA SIDESTEPS S&ED/JCCT COMMITMENTS -  
INDIGENOUS INNOVATION IN GOVERNMENT PROCUREMENT RANKLES  
U.S. FIRMS

REF: BEIJING 590

SENSITIVE BUT UNCLASSIFIED - PLEASE HANDLE ACCORDINGLY.

11. (SBU) Summary. Rules providing preference in government procurement for Chinese companies with accredited indigenous innovation appear to contravene China's S&ED and JCCT commitments to consider products produced by foreign-invested enterprises in China as domestic. A recent joint Ministry of Science and Technology, National Development and Reform Commission, and Ministry of Finance circular creating an accreditation system (catalogue) for national indigenous innovation products has alarmed U.S. high-tech firms who believe the new system will further block their access to Chinese government contracts. The deadline for applying to qualify for national indigenous innovation product status is December 10, 2009. We recommend a coordinated USG response to industry request for assistance in countering implementation of this circular. End Summary.

NEW INDIGENOUS INNOVATION ACCREDITATION SYSTEM CODIFIES  
BIAS FOR CHINESE IP IN GOVERNMENT PROCUREMENT

12. (SBU) Despite commitments by China at the July 2009 S&ED and the October 2009 U.S.-China Joint Commission on Commerce and Trade to treat products produced in China by foreign invested enterprises (FIEs) the same as products by Chinese enterprises for the purposes of Government procurement and to issue rules in this regard, U.S. high-tech firms here report a growing threat to their interests due to preferential policies favoring indigenous innovation products in government procurement.

13. (SBU) China's Ministry of Science and Technology (MOST), National Development and Reform Commission (NDRC), and Ministry of Finance (MOF) on November 6, 2009 issued circular G.K.F.J. No. 618 creating an accreditation system for national indigenous innovation products. Accredited products will enjoy preferential policies in government procurement. The circular is the most concrete proof of a

previously-rumored catalogue of products promoting indigenous innovation issued by MOST.

14. (SBU) China's promotion of homegrown innovation includes an array of policies and programs and is complicated by a lack of transparency in government procurement. Conflicts between the Government Procurement and Tender and Bidding laws create inconsistent definitions and allow for discriminatory application of rules. While these broader concerns remain part of USG's longer-term objective of bringing China into the WTO Government Procurement Agreement, this new measure may have an enormous and immediate impact on U.S. industry. It also raises questions about China's trade commitments, including its G-20 pledges to avoid trade protectionism.

15. (SBU) Representatives from Microsoft, IBM, Oracle, HP, Dell, and Texas Instruments, led by industry association U.S. Information Technology Office (USITO), met with Embassies November 23 to voice frustration over the joint MOST/NDRC/MOF circular and requested USG engagement to help counter the latest salvo in the PRC's offensive against foreign high-tech firms. According to one U.S. company's estimates, it has lost at least USD 100 million in business volume due to restrictive government procurement practices against it as an FIE. Other U.S. FIEs expect significantly larger long-term impact should the new system be fully implemented.

16. (SBU) According to related application instructions, MOF will prepare a catalogue of indigenous innovation

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products for government procurement on the basis of the needs of government procurement policies as well as actual conditions. Products should be of great significance, contribute much to or produce vital influence on economic and social development, be proprietary, and include Chinese intellectual property and Chinese proprietary brands. Six high-tech fields have been selected, including: computer and application devices; communication products; modernized office equipment; software; new energy and equipment; highly energy-efficient products. The products should also be symbolic and reflect China's indigenous innovation capabilities. The current deadline for submission is December 10, 2009.

17. (SBU) FIEs have already encountered roadblocks despite meeting all previously understood conditions to qualify as an indigenous innovation product. According to U.S. industry, the application of a U.S.-invested enterprise that did try to qualify for national indigenous innovation product status - by handing over their intellectual property and registering their trademark in China was denied.

18. (SBU) U.S. industry representatives have requested USG support, and are preparing to campaign various government agencies to reverse or defer indefinitely such an accreditation system. Industry representatives are also requesting formal clarification of discriminatory practices by local governments, urging them to issue rules to ensure that government procurement is conducted in a transparent and non-discriminatory manner and to prevent the recurrence of such discrimination.

LOCAL GOVERNMENTS GO EVEN FURTHER TO BLOCK FOREIGN PRODUCTS FROM PROCUREMENT

19. (SBU) Similar policies are taking root at the local level. In August 2009, local media reported a Beijing government official's claim that 51 Beijing products had been accredited as "indigenous innovation products", accounting for 21 percent of MOST's first batch of 243 products. According to that report, the Beijing government procurement market in 2008 stood at RMB 7.1

billion (USD 1.04 billion), among which RMB 2.7 billion, or 38 percent, was spent on indigenous innovation products.

¶10. (SBU) To date, MOST has refused to publicize the original catalogue of indigenous innovation products, claiming it is for internal use only. Industry contacts report that MOST has notified the accredited product companies individually, as well as having issued a press release which briefly states the catalogue is now available. Lack of transparency has inhibited FIEs and other stakeholders from effective engagement with the Chinese authorities.

¶11. (SBU) Additional discriminatory practices occur at the provincial level (see Reftel for background), most recently by the government of Hubei Province. Hubei's Director for Government Procurement Wei Chengyu has stated on various occasions that the Hubei provincial government had decided to exclude all foreign brand products from government procurement, regardless of their manufactured location. As stressed by Wei in a recent media report, defining whether a product is domestic or not should be based on whether the product contains indigenous intellectual property and only those controlled by enterprises of Chinese majority equity should be qualified as domestic products. The Hubei government, moreover, issued Document E'Cai'Han [2009] 21 on November 12, explaining that Hubei would maintain its government

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procurement policies into 2010, and continue to exclude products of foreign companies from government procurement, including those made by FIEs in China. Post's local IBM contacts report Hubei's practices may have already resulted in USD 1 million sales losses for its low-end X-series servers.

¶12. (SBU) Given that these immediate economic effects come on the heels of recent Chinese government S&ED and JCCT commitments to the contrary, and U.S. industry beliefs that these and other actions constitute significant obstacles and are inconsistent with fair competition, transparency, and with commitments to avoid trade protectionism, U.S. industry have requested USG intervention. Although further rule-issuing by the central government consistent with S&ED/JCCT commitments may not eliminate further misinterpretations by local governments, it would be a step in the right direction, according to U.S. industry.

#### COMMENT AND ACTION REQUEST

¶13. (SBU) China's unhurried progress toward accession to the WTO Government Procurement Agreement and its expanding efforts to use its rapidly growing government procurement budget to support domestic firms and promote domestic innovation in key industries does not bode well for U.S. high-tech firms that hold competitive technical advantage and have heavily invested in the Chinese market. While long-standing practices at both the central and local levels in China have suggested strong bias in government procurement for Chinese domestic intellectual property, the newly announced system makes it an explicit policy. We recommend a coordinated USG response to the new policy to respond to U.S. industry concerns and press for China to fulfill the commitments it made at both the S&ED and JCCT. End comment.

HUNTSMAN